IMMEDIATE ATTENTION

RP/CP/10/3

April 13, 2010

To: Members of the Pension Committee
(Mr. Portugal, Acting Chairman; Mr. Alazzaz, Mr. Fayolle, Mr. Kiekens, Mr. Mojarrad, Ms. Alonso-Gamo, Mr. Ghosh)

From: Padma Gotur, Committee Secretary

Subject: **The Fund's Contribution to the Staff Retirement Plan in FY 2011**

Attached for the Pension Committee's review and approval is a paper on the recommended contributions to the Staff Retirement Plan for FY 2011.

The actuarially determined contribution for FY 2011 is 19.29 percent of pensionable gross remuneration (PGR). In accordance with the existing funding framework, 14 percent would be contributed from the Administrative and Restructuring Budgets, and 5.29 percent would be drawn from the SRP reserve account.

The increase in the actuarially determined contribution rate from 0 percent for FY 2010 to 19.29 percent for FY 2011 is mainly due to the decline in the SRP's assets resulting from the global financial crisis. Table 4 of the paper provides a projection of the contribution rates based on updated assets as of December 2009. The partial recovery in the assets is expected to lower the contribution to 0 percent for FY 2012.

As discussed at the April 12, 2010 Board meeting on SRP reform, the five-year review of the actuarial assumptions and methods will take place this summer, and the results will be reported to the Pension Committee in the fall. This review will include projections of the Fund's contribution under varying rates of investment return, mortality and other economic and demographic assumptions impacting the SRP's contribution rates.

In the absence of a request from a member of the Pension Committee by the **close of business, Friday, April 23, 2010,** that the matter be taken up by the Committee, the Acting Chair will inform the Executive Board that the Fund's contributions for FY 2011, totaling $117.9 million, will be payable as: (a) $85.6 million (14 percent of gross remuneration) from the Administrative and Restructuring Budgets; and (b) $32.3 million (5.29 percent of gross remuneration) drawn from the SRP reserve account.

Questions may be referred to Mr. Clarke (ext. 34086) or Ms. Marzouk (ext. 39522) in HRD.

Att: (1)

Other Distribution:
Members of the Executive Board
Ms. Siegel
Mr. Rodlauer
Mr. Rosales

INTERNATIONAL MONETARY FUND

The Fund's Contribution to the Staff Retirement Plan in FY 2011

Prepared by the Human Resources Department

In consultation with the Finance and Legal Departments
and the Office of Budget and Planning

Approved by Shirley Siegel

April 13, 2010

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EXECUTIVE SUMMARY

Under the existing funding framework for the Staff Retirement Plan (SRP), the Fund's annual contribution is set at 14 percent of pensionable gross remuneration (PGR). The funding framework provides that any additional contribution needed to satisfy the amount determined by the Actuary for the SRP is drawn from the SRP reserve account.

The Actuary has indicated that the contribution rate for FY 2011 is 19.29 percent. Therefore, 14 percent of PGR would be contributed to Plan assets from the Administrative Budget and 5.29 percent of PGR would be drawn from the SRP reserve account. This sharp increase in the contribution rate (from 0 percent in FY 2010) is due primarily to the decline in the SRP's assets resulting from the impact of the global financial crisis.

Accordingly, this paper seeks the Pension Committee's endorsement of a contribution rate of 19.29 percent of PGR for FY 2011, which would be a contribution amount of about $117.9 million.[1,2]

[1] The PGR reflects the application of a tax grossing-up formula applied to staff net salaries. It is then used to determine both the Fund's and participants' SRP contributions. For the FY 2011 contribution estimate, the PGR was developed using actual year-to-date PGR for FY 2010 and adjusted for projected salary increases, turnover, and other factors as needed for the remainder of FY 2010 and for FY 2011.

[2] The 19.29 percent contribution for active participants is estimated to be about $113.9 million ($81.6 million payable from the Administrative Budget and $32.3 million drawn from the SRP reserve account), based on FY 2011 budgeted staffing levels, and the contribution for participants voluntarily separating is estimated at $4.0 million (payable from the Restructuring Budget).

I. Determining and Funding the Staff Retirement Plan Contribution

1. The Pension Committee and the Executive Board have established a funding methodology that is designed to ensure the Staff Retirement Plan's sound financial position over the expected lifespan of current retirees and active staff.

A. Regular Annual Contribution

2. Each year, an actuarial valuation is conducted to determine the recommended rate of the IMF's contributions to the SRP.[3] This contribution rate is determined using the actuarial cost method and actuarial asset method selected for the Plan. For the SRP, the Pension Committee adopted the *aggregate actuarial cost* method and a *five-year asset smoothing valuation* method.[4] Under these methods, the contribution rate is equivalent to the "normal cost" expressed as a percentage of pensionable gross remuneration (PGR).

3. The aggregate actuarial cost method determines the difference between: (1) the actuarial present value of projected benefits for existing participants as of the valuation date; and (2) the actuarial value of Plan assets and expected future participant contributions. This net liability is allocated as a level percentage of the PGR of current participants projected from the annual valuation date to assumed retirement dates, resulting in the rate of normal cost.

4. The actuarial value of Plan assets is determined under a five-year asset smoothing valuation method. This method reduces the volatility in Plan costs by recognizing asset gains and losses over a five-year period. Thus, in years when the market value of Plan assets declines due to market conditions, the Plan's costs would not increase to the extent that they would if only the current market value of assets were considered. On the other hand, when the market value of Plan assets increases, the Plan costs do not decrease to the same extent. A "corridor test" is applied to the actuarial value of Plan assets to ensure it remains within 10 percent of the market value of Plan assets. If the actuarial value of Plan assets is either more than 110 percent or less than 90 percent of the market value of Plan assets, the actuarial value is reduced or increased, respectively, to be at the corridor's limit.

5. The annual valuation is based on participant and asset data along with economic and demographic assumptions intended to reflect a best estimate of future events that would impact the Plan's liabilities. To the extent that Plan participation and experience differ from

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[3] The regular annual contribution rate is determined as an overall rate, reflecting the assets and liabilities of the SRP and the Supplemental Retirement Benefits Plan (SRBP). The SRBP was established in 1985 to receive contributions and to pay benefits in excess of limits set by U.S. tax law for "qualified" pension plans, such as the SRP.

[4] The actuarial methods were adopted in 1986 and last approved, with some modifications to the asset valuation method, in 2006. See *Staff Retirement Plan—Review of Actuarial Assumptions and Methods* (RP/CP/06/11, 10/12/06).

the assumptions, actuarial gains and losses will occur.[5] The Pension Committee is responsible for establishing the assumptions used in the annual valuation of the Plan.[6] The assumptions include the interest rate for discounting Plan liabilities, the rates of salary growth and inflation, and the rates at which Plan participants are expected to separate, retire, become disabled, or die. A summary of the key assumptions approved by the Pension Committee in 2006, and subsequently in 2008, is provided in Table 1 below.[7]

Table 1. Key Actuarial Assumptions

Actuarial Assumption	Annual Rate	
Interest rate	7.5 percent	
Salary growth	10.8 percent at age 21, decreasing to 6.4 percent at age 64	
Pension increases (cost-of-living adjustments)	4 percent	
Separation rates:		
Age	Men	Women
35	8.5	5.0
40	6.5	2.5
45	4.0	2.0
50	3.0	1.0
Retirement rates:		
Age	Rate	
50	5.0	
55	20.0	
60	25.0	
62	25.0	
64	55.0	
Disability	Up to 0.03 percent until age 30, increasing to 0.38 percent (males)/0.55 percent (females) at age 64	
Death	Up to 0.12 percent at age 45 and younger, increasing to 0.65 percent (for males) and 0.34 percent (for females) at age 60, and 0.98 percent (for males) and 0.53 percent (for females) at age 64	

[5] A gain represents a decrease in Plan costs, whereas a loss represents an increase in Plan costs.

[6] The Actuary for the Plan reviews the experience every five years, and makes recommendations for changes in the actuarial assumptions, as appropriate. The last five-year review took place in 2006. *Staff Retirement Plan—Review of Actuarial Assumptions and Methods* (RP/CP/06/11, 10/12/06).

[7] The retirement rate assumptions were revised to reflect the amendment to the Plan for the Rule of Age 50. *Staff Paper on Reform of the Staff Retirement Plan* (RP/CP/08/05, 1/22/08 and Cor. 1, 1/25/08).

B. Funding Framework

6. The current funding framework was adopted by the Executive Board in 2004 with a view to "normalizing" the Fund's budgetary payments to the SRP. Accordingly, the Fund contributes 14 percent of PGR annually from the Administrative Budget.[8] In years when the Actuary recommends a contribution rate exceeding 14 percent, the balance is notionally drawn from SRP reserves, accumulated from voluntary (prepaid) contributions made by the Fund in earlier years. If the reserves are exhausted, the Fund would meet the full actuarially indicated contribution from the Administrative Budget. In years when the Actuary recommends a contribution rate of less than 14 percent, the Fund contributes 14 percent, with the amount in excess of the Actuary's recommendation replenishing the SRP reserves.[9]

7. In January 2008, when the "Rule of Age 50" was adopted, the Pension Committee and the Executive Board reaffirmed the continued use of the funding framework and 14 percent annual contribution rate, to ensure the long-term financial stability and well-funded status of the Plan.[10]

8. The Fund's voluntary contributions and the resulting SRP reserve through FY 2010 are shown in Table 2. The reserve was replenished in FY 2008 through FY 2010, following a four-year period during which the reserves were used toward the annual rates of actuarially indicated contributions in excess of 14 percent. At the end of FY 2010, the reserve balance is projected to be $269.7 million.

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[8] The 14 percent rate reflects the long-standing 2:1 contribution ratio for the Fund and participants, where the latter contribute 7 percent of PGR, based on the actual long-term average Fund contribution. *The Fund's FY 2005 Contribution to the Staff Retirement Plan* (EBAP/04/31, 3/25/04).

[9] The Fund's voluntary contributions constitute a part of the Plan's assets; they are not available to the Fund for other purposes, nor do they constitute a separate account.

[10] *Staff Paper on Reform of the Staff Retirement Plan* (RP/CP/08/5, 1/22/08 and Cor. 1, 1/25/08).

Table 2. Voluntary Fund Contributions and Use of the Accumulated Reserves FY 1998 to FY 2010

(In U.S. dollars, unless otherwise indicated)

Financial Year	Annual Contributions/ Charges	Percent of PGR	Cumulative Contributions
1998	14,784,946	5.0	14,784,946
1999	15,873,558	5.0	30,658,503
2000	23,178,117	7.0	53,836,620
2001	18,874,109	5.0	72,710,729
2002	22,141,080	5.0	94,851,809
2003	24,259,747	5.0	119,111,556
2004	-18,270,873	-3.8	100,840,683
2005	-8,587,094	-1.2	92,253,589
2006	-21,650,230	-3.6	70,603,359
2007	-33,338,454	-6.1	37,264,905
2008	60,085,258	10.2	97,350,163
2009 1/	92,893,307	16.0	190,243,470
2010 (est.)	79,416,153	14.0	269,659,623

1/ Includes a supplementary contribution of $12 million. *Supplementary Contributions to the Staff Retirement Plan (SRP) and Retired Staff Benefits Investment Account (RSBIA) Within the Approved FY 2009 Budget Envelope* (EBAP/09/72, 5/14/09).

C. Approval Procedures

9. The decision on the annual contribution rate rests with the Executive Board on the recommendation of the Pension Committee.[11] The contribution rate calculated by the Actuary for the Plan on the basis of the established valuation methodology is put into effect automatically, unless the Pension Committee recommends, and the Executive Board approves, a different rate.[12]

[11] Executive Board Decision No. 8557–(87/52), adopted March 20, 1987, as amended by Decision No. 8804–(88/30), adopted March 3, 1988.

[12] The intent of this largely automatic procedure is to recognize the special nature of the Fund's obligation to finance the Plan.

10. The authority to determine when, and in what amounts, the accumulated voluntary contributions (also known as prepayments) are applied to reduce the Fund's required (actuarially determined) contribution rate rests with the Executive Board.[13]

II. Valuation Results

11. The Actuary's *Report on the Actuarial Valuation of the Staff Retirement Plan as of April 30, 2009* shows that a contribution rate of 19.29 percent is required for FY 2011.[14] A contribution is required when the present value of future benefit liabilities exceeds the Plan's assets (including the present value of future employee contributions). As shown in Table 3, the Plan liabilities exceeded the Plan's assets by $838.7 million, as of April 30, 2009, reflecting a significant decline in assets as of that date.

Table 3. Staff Retirement Plan Assets, Liabilities, and Contribution Rates FY 2010 and FY 2011

(In thousands of U.S. dollars, unless otherwise indicated)

	April 30, 2008 Valuation Results For FY 2010 Contribution	April 30, 2009 Valuation Results For FY 2011 Contribution
A. Plan liabilities	6,641,060	6,681,131
B. Actuarial value of assets	6,509,469	5,478,662
C. Employee contributions (present value)	375,871	363,731
D. Total assets (B+C)	6,885,340	5,842,393
Asset surplus (deficit) (D-A)	244,280	(838,738)
Contribution rate (in percent)	0.0	19.29

12. The required contribution rate increased from 0 percent to 19.29 percent, due primarily to the severe disruption in financial markets during FY 2009; the market value of Plan assets decreased from $7.2 billion as of April 30, 2008 to $5.1 billion as of April 30, 2009. While the actual return on the market value of assets in FY 2009 was -28.19 percent, as compared to the 7.5 percent assumed rate of return, only a portion of each year's return is reflected in the smoothed actuarial asset value. For the purpose of FY 2011 SRP contributions, the return on the actuarial asset value was -13.83 percent, or

[13] With respect to the use of the prepayments, Section 6.2 (a) of the Plan, as amended in 1998, provides that "[a]ny prepaid contributions (excluding any investment income, gains or losses thereon) may, as directed by the Employer, be used to reduce or eliminate any required contribution for a subsequent Plan year. The amount of the Employer's prepaid contributions shall be reduced to the extent that such prepaid contributions are used to reduce the Employer's funding requirements."

[14] There is a one-year difference between the contribution rate produced by a valuation and the financial year in which the rate is applied.

21.33 percent less than the assumed rate of 7.5 percent; this produced an actuarial asset loss of about $1,373.5 million.[15]

III. Impact of the Financial Crisis on SRP Funding

13. The Actuary has prepared estimates of the regular annual contribution rates over the next 20 years, based on the market value of Plan assets as of December 31, 2009 and three scenarios for the future investment performance of Plan assets.

14. Table 4 presents the estimated contribution rates and use of SRP reserves under the following scenarios (the assumed annual rate of return is prorated for the period January 1, 2010 to April 30, 2010):

- Baseline—assumed asset returns of 7.5 percent per year.
- Pessimistic—assumed asset returns of 5 percent per year through FY 2013, and 7.5 percent per year thereafter.
- Optimistic—assumed asset returns of 12 percent per year through FY 2013, and 7.5 percent per year thereafter.

15. With the availability of Plan reserves, the Fund's contributions from the Administrative Budget are projected to continue at the normalized rate of 14 percent beyond FY 2025, in the baseline scenario; under the pessimistic scenario, the contribution rate is not expected to exceed 14 percent until FY 2020. In the optimistic scenario, the contribution rate is projected to remain at 14 percent throughout the 20-year projection period.

[15] The actuarial asset loss is the amount by which the expected investment return (at the rate of 7.5 percent per year) exceeded the actual investment return for the year ended April 30, 2009. The expected investment return is calculated based on the assumed rate of 7.5 percent per year, applied to the May 1, 2008 actuarial asset value and the cash flow during the year (contributions and benefit payments). The Plan experienced an actuarial gain of $89.5 million from other sources (mainly participant demographic experience).

Table 4. Projected SRP Contributions Under Various Asset Return Scenarios 1/
(In millions of U.S. dollars, unless otherwise indicated)

	Actuarially Required Contribution Rate (in percent)	To (+) From (-) Reserves	Reserves (stock)	Normalized Fund Contributions (in percent)
Baseline Asset Returns (7.5%)				
FY10	0	79	270	14
FY11	19	-29 2/	241 2/	14
FY12	0	81	322	14
FY13	3	68	390	14
FY14	12	13	403	14
FY15	20	-41	362	14
FY20	16	-58 3/	304	14
FY25	17	-158 3/	146	14
FY30	18	-146 3/	0	18
Pessimistic Asset Returns (5%–FY2013, 7.5%)				
FY10	0	79	270	14
FY11	19	-29 2/	241 2/	14
FY12	0	81	322	14
FY13	4	61	383	14
FY14	15	-8	375	14
FY15	25	-76	299	14
FY20	21	-299 3/	0	17
FY25	21	0 3/	0	21
FY30	22	0 3/	0	22
Optimistic Asset Returns (12%–FY2013, 7.5%)				
FY10	0	79	270	14
FY11	19	-29 2/	241 2/	14
FY12	0	81	322	14
FY13	1	82	404	14
FY14	5	61	465	14
FY15	6	53	518	14
FY20	0	590 3/	1,108	14
FY25	4	656 3/	1,764	14
FY30	7	535 3/	2,299	14

1/ Based on the market value of Plan assets as of December 2009, and current plan benefits.

2/ The projected drawdown of SRP reserves after FY 2010, and the reserve balance, are based on the Actuary's projections using the actuarial valuation assumptions and the asset return assumptions indicated.

3/ Accumulated allocations to reserves during the prior five years.

16. It is useful to view the above scenarios and stress tests in a longer-term perspective. In the past, the Fund has experienced a number of episodes when required plan contributions were significantly higher than 14 percent for several years (such as in the mid-1980s, 1993–96, and 2005–07). These episodes have been more than offset by lower required contributions in other years; as a result, the average required contribution during 1986–2010 has been 10 percent.

IV. Upcoming Issues in FY 2011

17. **Five-Year Review of the Actuarial Assumptions.** In FY 2011, the Actuary will review the Plan's experience over the past five years, and develop recommendations for changes to the actuarial assumptions and methods, as appropriate. This study will include a financial analysis of the impact of the changes on the projected SRP contribution rates. Following the Administration Committee's review and endorsement, recommended changes will be submitted for the approval of the Pension Committee. The resulting changes, if any, will be reflected in the April 30, 2011 valuation and incorporated in the Fund's contributions beginning with FY 2013.[16]

18. **Pension Reform.** The Pension Committee endorsed proposed reforms to the SRP at its meeting on February 25, 2010. The proposals, which would take effect from May 1, 2011, preserve the SRP's basic defined-benefits design while recommending a number of improvements to support greater benefits portability and mobility to and from the Fund. The proposals would also update the SRP grossing-up formulae, in accordance with the existing rules of the SRP. Management is proposing a moderate reduction of the grossing-up formulae going forward, while providing protection for pension benefits accumulated under the current formulae. The combined effect of the proposed changes would reduce the Fund's actuarially determined contributions by about $7 million to $11 million per year, beginning in FY 2013.[17]

19. **SRBP Prefunding.** In December 2009, the Pension Committee approved a change to the prefunding procedure that has been followed since the inception of the Supplemental Retirement Benefit Plan (SRBP).[18] The procedure, referred to as "bullet" prefunding, was intended to ensure that eligible non-U.S participants who retired in the United States would receive the maximum allowable exemption from U.S. taxation on pension benefits. The procedure involved a lump sum contribution by the Fund to the SRBP shortly before the retirement of an eligible participant. In addition to the bullet contributions, the Fund makes

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[16] The current set of actuarial assumptions and methods will be used for the April 30, 2010 actuarial valuation.

[17] The proposed changes will first be reflected in the April 30, 2011 actuarial valuation, which will be the basis for the contribution rate for FY 2013.

[18] The change in prefunding procedure is explained in RP/AC/2009/18.

other contributions to the SRBP payable out of the Administrative Budget through bi-weekly payments coinciding with participant contributions through payroll, and ad hoc contributions when needed to meet the liquidity requirements of the SRBP, which operates on a pay as you go basis.[19] Consultations with outside legal counsel and the Fund's actuary concluded that the bullet prefunding procedure, initially established in 1985 in response to restrictive U.S. tax legislation on qualified pension plans, has become outmoded due to the subsequent adoption of a unified actuarial valuation of the SRP and SRBP and the accumulation of the combined resources in the SRP and SRBP. Accordingly, the Pension Committee discontinued bullet prefunding of the SRBP. Procedures will be developed, with the Actuary, to determine (on the basis of an annual review) the funding status of the SRBP and whether additional funding is required for the following year. The Actuary's preliminary review, in December 2009, indicated that no additional funding would be required for FY 2011. If it is determined that additional funding is needed for the SRBP in future years, these amounts will be paid from the approved SRP contribution from the Administrative Budget.

V. ADMINISTRATION COMMITTEE'S VIEWS

20. The Administration Committee continues to support the maintenance of a system in which the Fund's contributions are at least equal to the actuarially determined amount, and are subject to an automatic procedure for their implementation. In line with the funding framework, the Administration Committee supports the continuation of the 14 percent contribution from the Administrative Budget and a contribution at the rate of 5.29 percent (the amount higher than the 14 percent norm) drawn from the SRP reserves. The Administration Committee also supports the additional contribution from the Restructuring Budget, for participants on separation leave.

VI. CONCLUSIONS AND RECOMMENDATIONS

21. The actuarially determined contribution rate for FY 2011 of 19.29 percent of gross remuneration will become effective automatically unless the Pension Committee concludes that it should recommend a contribution rate different from the rate calculated by the Actuary, and the Executive Board agrees.

22. It is proposed that, in line with the funding framework, the Pension Committee recommend that about $117.9 million (the equivalent of 19.29 percent of PGR) be contributed from the Administrative Budget and the SRP reserve account in FY 2011.

23. The chairman will inform the Executive Board of these recommendations unless the Pension Committee recommends a different contribution rate. The Executive Board's

[19] The bi-weekly payments and ad-hoc contributions are paid from the approved SRP contribution from the Administrative Budget.

approval of the proposed funding and drawdown of the SRP reserves will be encompassed within the Board's decision to adopt the Administrative Budget for FY 2011.

Budgetary impact

24. As noted, the 19.29 percent contribution rate of PGR for FY 2011 is estimated to be about $117.9 million. In accordance with the funding framework, $85.6 million (14 percent) would be payable from the Administrative and Restructuring Budgets and $32.3 million (5.29 percent) drawn from the SRP reserve account.

- The 19.29 percent contribution would be paid to the Plan's assets from the Administrative Budget and accumulated reserves, as salaries and separation leave are paid.

- To the extent that affected staff separate before using their maximum separation leave entitlement, the Fund would make no further contributions to the SRP for those participants. [20]

[20] Every year, the Fund makes contributions to the SRP for participants who are on separation leave. Due to the scale of the downsizing exercise, these contributions are being highlighted for the Pension Committee and the Executive Board and accounted for in the Restructuring Budget rather than the Administrative Budget.